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**TRENDS AND OUTLOOKS**

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The review provides a detailed analysis of main trends in Russia's economy in 2007. The paper contains **five** big sections that highlight single aspects of Russia's economic development: the socio-political context; the monetary and credit and financial spheres; the real sector; social sphere; institutional challenges. The paper employs a huge mass of statistical data that forms the basis of original computation and numerous charts.

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## Russia's Economic Policy in 2007: Successes and Risks

### 1.2.1. Achievements and Problems

The economic and political results of 2007 are rather controversial. The evident successes displayed by economic dynamics were accompanied by alarming trends of growing populism. The current stability of economic and political life is fraught with risks of self-delusion and eminent destabilization. Presently there is a need for a serious analysis of achievements and opportunities, difficulties and risks of further development.

The achievements of last year were reflected in the positive dynamics of several basic socio-economic indices (*Table 1*).

*Table 1*

### Main Macroeconomic Indices of Russia's Socio-Economic Development

	1999	2000	2001	2002	2003	2004	2005	2006	2007
1	2	3	4	5	6	7	8	9	10
<b>GDP</b> ( billion rubles)	4,823	7,306	8,944	10,831	13,243	17,048	21,620	26,781	32,988.60
<b>GDP</b> (as percentage of previous year)	106.4	110.0	105.1	104.7	107.3	107.2	106.4	107.4	108.1
<b>GDP per capita – nominal</b> (in USD)	1,328	1,768	2,096	2,379	2,975	4,104	5,325	6,897	8,612
<b>Index of industrial growth</b> (as percentage of previous year)				103.1	108.9	108.3	104.0	103.9	106.3
<b>Agricultural product of farms of all categories</b> (as percentage of previous year)	104.1	107.7	107.5	101.5	101.3	103.0	102.4	102.8	103.3
<b>Investments in fixed assets</b>									
<i>billion rubles</i>	670.4	1,165.2	1,504.7	1,762	2,186	2,865	3,611	4,580.5	6,419
as percentage of previous year	105.3	117.4	110.0	102.8	112.5	113.7	110.7	113.7	121.1
<b>Accumulated foreign capital in Russia's economy</b> (billion USD)							111.8	142.9	220.6
<b>Foreign investments</b> (billion USD)	9.6	11.0	14.3	19.8	29.7	40.5	53.7	55.1	120.9
including									
<i>direct</i>	4.3	4.4	4.0	4.0	6.8	9.4	13.1	13.7	27.8
<i>portfolio</i>	0.031	0.145	0.451	0.472	0.401	0.333	0.453	3.2	4.2
<i>other</i>	5.3	6.4	9.8	15.3	22.5	30.8	40.1	38.2	88.9
<b>Foreign trade turnover</b>									
<i>billion USD</i>	115.1	149.9	155.6	168.3	212.0	280.6	369.2	468.6	578.3
as percentage of previous year	86.9	130.2	103.8	108.1	126.0	132.4	131.5	127.0	123.4
<b>Exports</b>									
<i>billion USD</i>	75.6	105.0	101.9	107.3	135.9	183.2	243.8	303.9	355.2
as percentage of previous year	101.5	139.0	97.0	105.3	126.7	134.8	133.1	124.7	116.9
<b>Imports</b>									
<i>billion USD</i>	39.5	44.9	53.8	61.0	76.1	97.4	125.4	164.7	223.1
as percentage of previous year	68.1	113.5	119.8	113.4	124.8	128.0	128.8	131.3	135.4
<b>Retail trade turnover</b> (as percentage of previous year)	94.2	109.0	111.0	109.3	108.8	113.3	112.8	113.0	115.2
<b>Consumer price index</b> (as percentage of December of previous year)	136.5	120.2	118.6	115.1	112.0	111.7	110.9	109.0	111.9
<b>Industrial producers' price index</b> (as % of December of previous year)	170.7	131.9	108.3	117.7	112.5	128.8	113.4	110.4	125.1
<b>Total number of unemployed, period's average</b>									
<i>million persons</i>	9.4	7.6	6.4	5.8	6.2	6	5.6	5.3	4.6
as percentage of corresponding period of previous year	116.0	82.0	83.2	89.2	107.3	96.1	90.2	95.6	88.3
as percentage of economically	13.0	10.5	9.0	8.1	8.6	8.3	7.7	7.3	6.1

active population

<b>Average monthly charged wage of one employee (rubles)</b>	1,523	2,223	3,240	4,360	5,499	6,740	8,555	10,634	13,518
<b>Real charged wage of one employee (as percentage of corresponding period of previous year)</b>	78.0	120.9	119.9	116.2	110.9	110.6	112.6	113.4	116.2

Table 1 (continued)

	1	2	3	4	5	6	7	8	9	10
<b>Average money incomes per capita, per month (rubles.)</b>	1,658.9	2,281.1	3,062.0	3,947.2	5,170.4	6,410.4	8,023.2	9,947.3	12,490	
<b>International reserve assets (as of end of period, billion USD)</b>	12.5	28.0	36.6	47.8	76.9	124.5	182.2	303.0	476.4	
<b>RTS Index</b>				359.07	567.25	614.11	1,125.6	1,921.92	2,290.51	
<b>Aggregate volume of resources in Stabilization Fund of Russian Federation</b>										
<i>billion rubles</i>					106	522.3	1,237.0	2,346.92	3,849.1	
<i>billion USD</i>						18.8	43.0	89.1	156.8	

• Sources: Rosstat, Ministry of Finance of the Russian Federation ([www.minfin.ru](http://www.minfin.ru)), Federal State Statistics Service ([www.gks.ru](http://www.gks.ru)), Central Bank of the Russian Federation ([www.cbr.ru](http://www.cbr.ru)).

GDP growth by 8.1% represents one of its highest rates throughout the post-crisis period and is indicative of the Russian national economy's serious potential (this index was higher only in 2000 (10%), but then it had been a pure example of rehabilitative growth). Industry's growth became even more rapid, being 6.3 % against 3.9 % in 2006, and in the manufacturing industries – as high as 9.3 %. The manufacturing industries are displaying an accelerated growth by comparison with the extraction of mineral resources (9.4 % and 2 %, respectively). Now, this dynamics can no more be explained by either the ruble's low exchange rate or the presence of surplus capacities. It is quite obvious that the rehabilitative period is over, and the economy is switching over to an investment-based growth model.

The growth of investments has indeed reached its absolute historic high, amounting to 20 %. The volume of foreign investments was 120 billion USD (against 55 billion USD in 2006), while that of direct investments – 20 billion USD (against 14 billion USD).

An important factor contributing to the Russian economy's dynamic growth has become the rapid growth in household consumption, amounting to approximately 13.1 %.

Stable growth was demonstrated by the most important indices of the budgetary and monetary systems. The Russian Federation's foreign currency reserves exceeded 450 billion USD, while the Stabilization Fund amounted to 150 billion USD. The budget continued to display a surplus, although now it was lower by approximately 2 p.p. of GDP. External government debt amounted to a negligible sum of about 4.3% of GDP.

The doubtless (and important) last year's result has become the inertia-level dynamics ultimately acquired by national projects. They have finally been taken seriously by society, and not just as part of propaganda campaigns. One more contributing factor in this respect was D. Medvedev's nomination as candidate for the post of RF President, which served as a sign of a long-term character of the selected priorities.

Finally, the institutional (as opposed to purely financial) problems associated with the functioning of sectors aimed at developing human capital began to be discussed in earnest. Some positive trends have appeared in the ways the problem of the nation's health are being approached.

Unemployment continued to be on the decline, its level in one year dropping by 7.3 p.p., while the average monthly wage exceeded 500 USD.

One of the recent positive trends has been this country's political and economic elite's growing interest in long-term development issues. The Government's three-year program was augmented by a three-year federal budget and the Government's report on the results and main directions for the Government's activity, also encompassing a three-year period.

Last year the Government began elaborating this country's Long-Term Strategy of Socio-Economic Development for the period until 2020. This is to be followed by long-term budget projecting. Besides, prospective documents are also to be developed at the level of the federation's subjects and municipal formations. It is planned that all these documents should be united within a single system by means of issuing a federal law on this country's socio-economic development strategy, which is being mapped on the RF President's assignment.

Russia is not unique in this respect. The desire to develop long-term planning and forecasting documents has been demonstrated, in the past two years, by nearly all the post-Soviet countries – members of the CIS<sup>1</sup>. It appears that there are two reasons for such an interest on their part. On the one hand, this interest is pragmatic, because stabilization and economic growth have made such goals both achievable and desirable. On the other, there are traditions dating back to the days of the Soviet economy, since a considerable part of the post-Soviet state elite have their roots within their Gosplan past, and the existence of so many forecasting documents clearly reflects the influence of the directive-based planned system with its main attribute – “marks” given for plans. These principles are quite dangerous, if attempts are made to consistently implement them in a situation of a modern-type dynamic economy.

At the same time, the year 2007 saw the emergence of some *alarming trends* in economic development and economic policy.

The main problem, which became the focus of both the political leaders' and the population's attention, was an accelerated growth of prices. From the year 1999 onward the inflation rate in Russia had been steadily declining, although more slowly than forecasted in budget projecting. Until last year, the discussions of this problem were mainly centered on the accuracy of forecasting, since the Government's estimations had always been more optimistic than the actual results. However, everybody understood that this had to do with the authorities' wish to obtain additional nominal revenues by a year's results, and so, political criticism in parliament quite apart, these rules of the game were, after all, universally accepted. However, in 2007 inflation for the first time began to accelerate, and significantly so – the consumer price index leaped from 9% to 12%, while the producers price index exceeded 25%. An acute discussion as to the causes of such a turn of events followed. Three main causes were pointed out as being quite obvious:

- growing prices of foodstuffs on the international markets;
- efforts on the part of monetary authorities to restrict the ruble's strengthening;
- and an expansionist budgeting policy.

The latter factor is of particular importance, since in 2007 budgeting policy underwent considerable changes. Now one may already speak of the onset of a large-scale budget expansion. In spring it was decided that budget expenditure should be increased against the previously approved Law “On the 2007 Federal Budget”. The corresponding draft law was approved in November. The suggested amendments were aimed at increasing non-interest revenues by more than 1 trillion rubles, which resulted in budget surplus being decreased from 4.8% to 2.8% of GDP. A considerable amount of additional budget resources was allocated to social and infrastructural projects, as well as to capitalization of state corporations and development institutions (the Bank of Development, the Investment Fund, the Russian Nanotechnologies Corporation, the Fund for Promoting Reform of the Housing and Utilities Sector, etc.). All this has led to the conclusion that *populist trends are becoming increasingly prominent in Russian economic policy*.

From the point of view of formal balancing, the weakening of budget constraints should not result in budget deficit in the next three years, if the current forecasts of oil prices remain true. However, such undertakings have served as a clear indication to economic agents, who

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<sup>1</sup> See a collection of articles on the contemporary experience of prospective planning and forecasting in some CIS countries published in the journal “Obshchestvo i ekonomika” [“Society and the Economy”] (2007, No. 1112).

have accordingly adjusted their pricing policies, which have been then reflected in accelerated inflation.

The transition to an expansionist budgeting policy could only in part be explained by the specific features of the current political cycle. Last year's pre-election character was, no doubt, a political reality. However, the high ratings of the present President and "United Russia" made such budgeting populism rather unnecessary. The growth of budget expenditure was caused not so much by the standard peculiarities of the political and business cycle, but by the unprecedented pressure on the RF Ministry of Finance from all the sectors of the national economy and political forces. The presence of substantial monetary resources in a country plagued by serious social and economic imbalances has become a factor of a very strong pressure, suppressible by the financial authorities only if they are decisively supported by the head of the State. But even this support cannot be unlimited, which was fully demonstrated last year.

The reverse side of budgeting expansion has become the slow-down in implementing institutional reforms. Here one can also observe the influence of the political cycle: reforms are unlikely in a pre-election period, and the only thing to be done then is to develop the basic outlines of economic policy for the "window of opportunity" that may appear soon after the election. However, this does not mean that institutional transformations are going to be curbed completely. In some sectors relating to priority national projects certain important institutional decisions have been made, thus determining the principles of their functioning during the forthcoming period (primarily in the sphere of public education).

Some alarming symptoms have been noticed on the external debt market. The amount of sovereign external debt continued to decline alongside increasing private external debt. Besides, last year also saw an important change in this trend: if previously the aggregate debt load had been diminishing, in 2007 it began to grow. This has significantly increased the dependence of Russia's economic situation on the fluctuations of the international financial one. Moreover, a considerable part of the debt is accounted for by quasi-private (but actually controlled by the State) corporations and banks, which means that the government will have to act as their savior in an event of economic crisis. One can speak of a growing trend toward chaebolization of a number of prominent Russian companies, as exemplified by South Korean chaebols (that is, companies actually controlled by the State and governed on the principle of "privatization of profits and nationalization of losses").

A serious problem observed last year was, as before, the ruble's strengthening as a result of a substantial capital inflow created by both proceeds from exports and foreign investments. Big corporate borrowings did indeed play their part in this process. As a consequence, Russia's imports were rapidly growing, which was in no way conducive to the activity of domestic manufacturers. However, the competitive capacity of domestic production was undoubtedly increasing, which has been proved by the very fact of accelerating economic growth, although the ruble's purchasing power has long ago been exceeding the level of 1997 – which has been regarded by some Russian analysts as very dangerous and fraught with a new crisis.

Another alarming, although also a logical trend in the second half-year 2007 became the increased interest rates on the interbank market. This was largely the result of the mortgage crunch in the USA, although a certain part had also been played by increased inflation expectations. In this connection, the measures undertaken by the Central Bank of Russia were decisive and adequate, thus preventing further development of this crisis, which was almost unnoticed by the majority of Russians.

Finally, the processes of social differentiation were developing at a more profound level. Russian society has got used to this process in the course of the past one and a half decades, given that differentiation has so far been increasing against the backdrop of an overall growth of well-being (in terms of wages and the population's incomes). However, the long-term implications of this trend may become rather dangerous.

Thus, the total results of the current situation's development in 2007 are rather controversial. Some important successes are undeniable, but the situation remains intrinsically unstable. Below we are going to discuss in more detail the causes of this lack of stability and the possibly applicable compensatory mechanisms.

### 1.2.2. The problems of Economic Growth

Last year was characterized by a high rate of economic growth, which became even slightly accelerated by comparison with the year 2006.

Nevertheless, the dynamics of Russian GDP is by no means unique, if one takes a look at the post-communist space as a whole. The growth rates displayed by a majority of the former USSR countries were higher than that in Russia. This was a feature typical not only of those post-Soviet countries where the higher growth rate was to a certain extent the result of the "base effect" (depth of slump) and the continuing effect of the remaining rehabilitative trends, but also of the countries of Central and Eastern Europe, which joined the EU and created in their territories some economic institutions that were not entirely conducive to economic growth<sup>2</sup>. Exceptionally high rates are characteristic of China and India. The data in *Table 2* also vividly demonstrate that high growth rates are not necessarily the result of high international prices of energy carriers. High growth rates are also displayed by Azerbaijan, Turkmenistan and Kazakhstan, while at the same time growth in most of the countries deficient in natural resources is higher than that in Russia. Thus, the source and reserves of growth should be looked for in factors other than those governing the development of the oil and gas sector.

It seems that we are now in the upward phase of the economic cycle, and it can be assumed that the Russian economy has indeed entered the system of a normal business cycle. It is for the future to prove the truth of this assumption, but in any case time has come for us to depart from the stereotypes of anti-crisis management and whipping up growth at any cost, and to formulate an economic policy model based on the mechanisms of cyclic regulation. In other words, it is time to switch over from an anti-crisis policy to a cyclic one.

*Table 2*

### GDP Dynamics in Post-Communist Countries, in %

Country	Years	
	2006	2007
<i>Azerbaijan</i>	31.0	29.3
Albania	5.0	6.0
Armenia	13.3	11.1
Belarus	9.9	7.8
Bulgaria	6.1	6.0
Hungary	3.9	2.1
Georgia	9.4	11
Kazakhstan	10.7	8.7
Kyrgyz Republic	2.7	7.5
China	11.1	11.5
India	9.7	8.9
Latvia	11.9	10.5
Lithuania	7.5	8.0
Macedonia	3.0	5.0
Moldova	4.0	5.0
Mongolia	8.6	8.5
Poland	6.1	6.6
Romania	7.7	6.3
<b>Russia</b>	<b>6.7</b>	<b>8.1</b>
Serbia	5.7	6.0
Slovakia	8.3	8.8
Slovenia	5.7	5.4

<sup>2</sup> The issue of the restricting effect of the membership in the EU on economic growth was analyzed by A. Aslund and A. Warner (see Aslund A., Warner A. *The EU Enlargement: Consequences for CIS Countries // Beyond Transition. Development Perspectives and Dilemmas.* Aldershot: Ashgate, 2004).

Tajikistan	7.0	7.5
Turkmenistan	9.0	10.0
Ukraine	7.1	6.7
Uzbekistan	7.3	8.8
Croatia	4.8	5.6
Czech Republic	6.4	5.6
Estonia	11.2	8.0

- *Source:* International Monetary Fund (IMF).

Meanwhile, the State continues to follow the principle of “growth at any cost”. Despite the economic boom and associated inflation, the government is promoting further growth through budget allocations. These allocations are mainly earmarked for the social sphere (investments in human capital), infrastructure development, and innovative activity. This approach is quite understandable because these sectors, in fact, contain the bottlenecks restricting this country’s development. Also understandable is the political context of this approach – for the present-day Russian authorities, a high rate of growth represents the source of their legitimization – a kind of a “social contract”, typical of the first phase of post-revolution stabilization. However, all these measures appear strange enough in a situation of economic boom and high inflation rate. The risks of the economy getting overheated and then spiraling down into crisis are thus becoming very real.

Economic growth so far has remained predominantly quantitative. Although the services sectors are growing at high rates, they offer mainly traditional services (primarily those of intermediaries in trade), and not high-tech ones. The special economic zones for the implementation of technologies are indeed developing, but they have not yet become the foci for innovations growth capable of influencing the character of economic growth in any significant way. Russia is developing within the framework of an industrial model, having no serious competitive advantages in such a system of coordinates – in terms of either human resources or natural and climatic parameters<sup>3</sup>. However, structural transformation is a lengthy process, which accumulates its potential slowly and can fully unfold only over time. At the same time, it is impossible to judge in advance whether the accumulation of forces for a future structural breakthrough is indeed currently under way<sup>4</sup>.

There exists a need for decisive structural shifts designed to diminish the country’s dependency on the situation in the fuel and energy complex. This goal has been determined as the core of the Concept of the Long-Term Socio-Economic Development of the Russian Federation, encompassing the period until 2020; its draft was prepared by the RF Ministry of Economic Development and Trade in the second half of 2007. When setting, as the goal for the next 12-year period, Russia’s joining the top five economies of the world (by its GDP size), the Concept envisages three possible scenarios of long-term development: this country’s continuous inertia, or an economy based on export of raw materials, or innovations. The main parameters of the three scenarios are presented in *Table 3*.

*The inertia-based scenario* assumes that the raw materials sectors will continue to prevail in the national economy, against the backdrop of a gradual slowdown in the growth rate of extraction and exports of the products yielded by the fuel and energy complex (FEC) resulting from underdeveloped infrastructure. The average per annum growth rates will not exceed 3.5%. If this scenario is realized, it is unlikely that any large-scale investment projects will be undertaken in any sectors beyond the FEC. However, there is still the possibility of an

<sup>3</sup> There exist some studies aimed at providing a proof of the Russian economy’s fundamental inability to be competitive even in face of a preserved industrial paradigm, which can be explained by a set of natural (primarily nature- and climate-related) factors. However, the specific features of a postindustrial (informational) economy have significantly changed the relative importance of such factors and make it possible to view the issues of national competitive capacities at a new angle. (See, e. g., Lynch Allen C. *Roots of Russia’s Economic Dilemmas: Liberal Economics and Liberal Geography // Europe-Asia Studies*. 2002. Vol. 54. No. 1).

<sup>4</sup> One should recall the experience of developed countries of the West in the 1970s, when many observers believed that they were stagnant, demonstrating to the rest of the world their low growth rates and high inflation rates, whereas in fact they were accumulating a potential for their subsequent powerful structural breakthrough.

intensification of the processes of social and regional differentiation, a decline in the quality of human capital, a reduction in the competitive capacities of manufacturing industries and their substitution by imports.

*The scenario envisaging the supremacy of export of raw materials* builds upon Russia's competitive advantages in the energy sector and the implementation of large-scale infrastructural projects, thus making it possible to increase the industrial capacities of the traditional branches of Russian exports. The average per annum growth of the national economy will in this case amount to approximately 5.5%. Special attention will be focused on the development of power engineering and transport, while owing to the specificity of these sectors it can be expected that the State's role in the organization and regulation of economic life will become more prominent. In this scenario, the necessity to establish public-private partnerships will become especially important. Such a scenario, naturally, will imply Russia's increasing dependency on the international prices of the FEC's products and raw materials.

*The innovations scenario* builds upon the use of Russia's competitive advantages existing in the sector of fuel and raw materials in order to diversify and qualitatively upgrade this country's national economy. In this case, of fundamental importance will be the ability to make a dramatic breakthrough in the quality of human capital and to use it as a base for creating hi-tech production capacities. Economic growth may become as high as 6–6.5% per annum. In effect, this is a scenario of Russia's postindustrial breakthrough enabling it to find its own niche within the labor division system resulting from the current globalization processes. The scenario envisages a structural maneuver resulting in the innovations sector's share increasing from the present-day level of 10% of GDP to approximately 20%, while the oil and gas sector's share will, on the contrary, diminish from the currently observed 20% to 10–12%.

Table 3

### Scenarios of Russia's Socio-Economic Development in 2011–2020

Parameters	2011–2015	2016–2020
<b>GDP – average per annum growth in %</b>		
<i>inertia</i>	103.2	103.2
<i>exports of raw materials</i>	105.7	105.0
<i>innovations</i>	106.3	106.6
<b>Industrial production – average per annum growth in %</b>		
<i>inertia</i>	102.3	102.3
<i>export of raw materials</i>	104.7	104.2
<i>innovations</i>	105.2	105.0
<b>Investments – average per annum growth in %</b>		
<i>inertia</i>	102.8	104.3
<i>export of raw materials</i>	109.2	107.4
<i>innovations</i>	110.2	110.1
<b>Real disposable incomes of the population – average per annum growth in %</b>		
<i>inertia</i>	104.3	103.9
<i>export of raw materials</i>	106.2	105.0
<i>innovations</i>	107.2	106.9
<b>Real wage – average per annum growth in %</b>		
<i>inertia</i>	104.4	103.9
<i>export of raw materials</i>	107.5	106.0
<i>innovations</i>	108.2	108.2
<b>Retail turnover – average per annum growth in %</b>		
<i>inertia</i>	104.2	103.9
<i>export of raw materials</i>	105.9	104.7
<i>innovations</i>	106.6	106.4
<b>Exports – average per annum growth in %</b>		
<i>inertia</i>	101.3	101.8
<i>export of raw materials</i>	103.3	103.5
<i>innovations</i>	103.5	104.5
<b>Imports – average per annum growth in %</b>		
<i>inertia</i>	101.7	103.5

<i>export of raw materials</i>	106.2	104.9
<i>innovations</i>	106.9	106.7

- *Source:* the Ministry of Economic Development and Trade of the Russian Federation.

With a certain degree of conventionality, these three scenarios can be termed “Nigerian”, “Mexican” and “Australian”, respectively. Nigeria is a country where the abundance of fuel and energy resources produced stagnation and the degradation of political and economic institutions resulting in a severe political and economic crisis. In Mexico, the enormous revenues from oil production ensured a noticeable although uneven economic growth, accompanied by a moderate diversification of the national economy and low level of human capital development, while the existing institutions were unable to take advantage of the proximity to the North American market. And lastly, Australia is demonstrating its successful experience of a country rich in natural resources. The substantial revenues generated by the export of natural raw materials to Japan and the countries of South-East Asia were used for diversifying the country’s domestic production and creating a modern postindustrial economy<sup>5</sup>.

These three scenarios cannot be regarded as three alternatives. Rather, they represent three successive phases in the Russian economy’s movement toward obtaining new qualitative properties. A favorable variant of development will involve a transition from the inertia-based scenario to export of raw materials, and then, on this newly created base (and with due regard for the Australian experience), to increasing the role of innovation mechanisms in socio-economic development. In other words, the first and the second scenarios are simple successive stages on the way toward providing solutions to Russia’s strategic goals of development. However, these variants may also become alternative ones, if it becomes impossible to achieve transition from one stage to another.

Then, one key question will arise: what can ensure the transition between different growth models? In principle, there exist two mechanisms of influence – money and institutions. The switchover from one development model to another may be achieved by a country by means of large-scale (and associated with the State) investments in certain sectors of the national economy and in-depth institutional reforms designed to create favorable conditions for the operation of economic agents, as well as incentives for an accelerated development of the branches promoting growth of human capital.

But here we are faced with the actually existing alternatives in the choice of a strategy for Russia’s socio-economic development. *One strategy* builds upon the ideology of dirigisme and envisages the State’s leading role in ensuring the desirable rate of economic growth by specifically creating strong organizational and financial preconditions. The leaders in the game thus become the corporations formally owned or unofficially controlled by the State. The state budget begins to play an active part in providing funding for big economic projects, and not only for those being implemented in the infrastructural sphere. Special “development institutions” are created, whose purpose is to provide special conditions for sectors treated by the State as preferential ones. The institutional system is tailored to serve the State’s leading role, including in relation to property issues, bankruptcy, foreign economic activity, etc.

This model can indeed ensure high rates of economic growth during a certain phase, especially if there is a strong inflow of financial resources into the state budget. However, the problem inherent in this model is the well-known low efficiency of state investments (including those made by the State through formally private agents), as confirmed by practical experience, by comparison with truly private investments, when the investor puts at stake his own money. And this low efficiency has two aspects to it.

Firstly, there is the inefficiency of decision-making concerning investment priorities, which becomes a most acute problem in the highly dynamic conditions of the postindustrial era.

<sup>5</sup> For more details, see Mau V. Rossiiskaia ekonomika: sil’nye i slabye storony. [The Russian economy: strengths and weaknesses] // Ekonomicheskaiia politika [Economic Policy]. 2006. No. 2; Brich A. Put’ Rossii k protsvetaniiu v postindustrial’nom mire. [Russia’s way to prosperity in the postindustrial world] // Voprosy ekonomiki [Issues of Economics]. 2003. No. 5.

Nowadays, challenges and priorities change so quickly that any state bureaucracy, no matter how efficient, is simply unable to respond to these changes in a timely and adequate manner. The decisions made by authorities always result from a complex system of coordinated interests. And the challenges presented by a current situation are by no means the most important argument in such a context. Moreover, sometimes it is virtually impossible to change a decision arrived at after so many difficulties, once it is made.

Secondly, there still remains the notorious problem of inefficient (inflated) estimations of the cost of investment projects involving the spending of public (or quasi-public) funds<sup>6</sup>.

The basis for another approach to modernization would be the formation of a modern institutional environment capable of promoting stable economic growth and adaptable to contemporary challenges. It is specifically the use of modern institutions (naturally, appropriately adapted to the individual features of a given country) that can serve as the most important source for modernization in countries involved in catching-up development in a situation of transition toward the postindustrial era. And it is the stage-by-stage formation of institutions peculiar to a modern developed society (the institutions of modern market democracy) that is particularly conducive to providing solution to a complex set of modernization-oriented problems.

Last year, the State's attention was focused on the financial and regulatory ("dirigisme"), rather than institutional, aspects of economic growth. This was achieved mainly through pumping money into development institutions, as well as through creating public corporations designed to play key roles in the Russian economy's structuring. This sequence of events is quite natural in a situation of a strong inflow of "cheap money", which has been flooding this country for several years in a row.

The direct outcome of such developments has been so far only the further enhancement of inflation. Modern inflation is a rather complex phenomenon, produced by a variety of factors: growing prices of foodstuffs, the striving of monetary authorities to restrict the ruble's strengthening, as well as an expansionist budgeting policy. The latter circumstance was playing a particularly important role in the realities of the year 2007.

Budget expansionism aimed at promoting growth, in fact, represents a growth-restricting factor. On the one hand, additional demand, instead of promoting domestic production, is largely focused on imported goods. On the other, inflation results in banks increasing their interest rates on the domestic market (as it happened in the autumn of 2007), which is an unfavorable circumstance from the point of view of growth consolidation. This latter phenomenon is also conducive to increasing the competitive capacities of imports by comparison with those of domestic manufacturers.

### 1.2.3. Institutional Factors of Economic Growth

One of the main issues involved in the discussion of economic growth has been the formation of modern – that is, adequate in terms of its responses to the challenges of the postindustrial era – system of political, economic and social institutions. The key role of the building of appropriate institutions has been rather well substantiated in the literature published in course of the past two decades.

While analyzing the institutional problems that need to be solved in order to ensure stable economic development and structural transformation in contemporary Russia, it is feasible to single out several categories of institutions and to determine their intrinsic hierarchy based on logic. There exist *four categories of institutions*.

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<sup>6</sup> For an interesting analysis of the efficiency of public investment utilization, see Fluvb'erg B. Strategicheskaya otsenka planirovaniya krupnykh infrastrukturykh projektov. [A strategic estimation of plans for big infrastructural projects] // Ekonomicheskaya politika [Economic Policy]. 2006. No. 1. It should be noted that the author of this article discusses the experience of developed market democracies, for which rather high standards of government decision-making are typical.

*Firstly*, the political and legal institutions designed to ensure the civil and political rights of citizens, and economic agents in particular. These have to do with the protection of basic rights, whose recognition by the State once became the foundation of modern economic growth. Here belong the guarantees of inviolability of person and property, independence of courts of justice, efficiency of the law enforcement system, and freedom for the mass media.

*Secondly*, the institutions ensuring human capital's development. First of all, this applies to public education, public health care, the pension system and housing provision. It would have been an error to reduce the problems existing in these sectors to those associated with insufficient funding. In fact, the key problem of their development lies in the need for institutional reforms, that is, the emergence of new rules for their functioning. The majority of the currently functioning models in the social sphere were created at the time when the agricultural economy was transforming into an industrial one, characterized by a set of entirely different conditions (demographic, social, etc.). At present, when the situation in developed countries, Russia including, has undergone fundamental changes, the traditional (that is, elaborated at the turn of the 20<sup>th</sup> century) social support institutions are becoming too expensive and inefficient.

*Thirdly*, economic institutions proper, that is, economic legislation appropriate for the stable functioning and development of the national economy. Modern legislation must be capable of ensuring economic growth and structural modernization of the economy.

*Fourthly*, specialized institutions designed to provide solutions to certain specific problems associated with economic growth, namely those that have recently been termed "development institutions", that is, establishing rules of game applicable not to all the participants in economic or political life, but only to some of them, specially selected. In other words, these institutions exert discretionary influence on the economy, in contrast to the previously existing one, whose influence was of a general nature.

The four categories of institutions are listed in the order of their relative importance and logical hierarchy. It is the guarantees of basic rights that can create the base of stable economic growth, as well as its fundamental prerequisites – at least within an economy that builds upon private entrepreneurship. It should be emphasized that we mean primarily the issues of personal and property safety, and of the efficiency of state administration, and not the well-known set of political rights typical of modern market democracies. As demonstrated by the experience of the past three centuries, confidence in personal safety and in that of the accumulated wealth can create sufficient preconditions for active entrepreneurship, irrespective of whether an entrepreneur is granted passive, or even active, voting right, or lives under a republican system or a monarchy, etc. In order to ensure adequate guarantees, of far greater importance is the existence of a reliable judicial system and law enforcement mechanisms, which are also conducive to lower transaction costs and increasing business competitiveness. And the independent mass media perform the function of public control over the operation of those institutions. At the same time, the traditional democratic institutions are also necessary for a country to achieve a certain level of socio-economic development, especially if there is a prevalence of educated urban population.

The recent economic and political discussions are largely characterized by a viewpoint that the modernization of a political system is not an issue of paramount importance. There exist two lines of argumentation in its support.

One of them emphasizes the specific character of Russia's political institutions (and, accordingly, the institutions of democracy) as compared to modern developed democracies. Such argumentation implies that this country has its own individual way of development, which cannot be a replica of that of Western democracies. The gist of this viewpoint can be found in the concept of "sovereign democracy" that has been discussed in the past two years<sup>7</sup>.

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<sup>7</sup> The materials relating to the discussion of this theme can be found in the following collection of essays: *Pro suverennuiu demokratiu* [Pro sovereign democracy]. M.: Evropa, 2007.

The other viewpoint, while recognizing the modern Western model as a target for developing domestic political institutions, does not regard such institutions as a necessary precondition for consolidating economic growth in this particular phase of this country's evolution. In a visible perspective, stable growth is linked not to the formation of a modern efficient state administration system, but to the existence of a potential for catching-up development based on borrowed technologies. It is these technologies that could ensure a high rate of economic growth even in face of underdeveloped institutions. And only at later stages, after the modernization of the economy's industrial branches is accomplished, that of political institutions will provide the ground for this country's further development.

This viewpoint is at least an arguable one. It is quite applicable to the countries transiting from an agricultural economy to an industrial one, that is, those undergoing industrial modernization. Their predominantly agrarian population is, as a rule, very sensitive to improving well-being and does not display a demand for modern political institutions. The response of the urban educated population is quite different – it demands certain guarantees, and therefore is prepared to participate in government decision-making. That is why *the modernization of the political system is an absolute priority in terms of providing adequate solutions to all the other problems relating to economic and social modernization.*

The second very important factor determining the success of modernization is the development of human capital. This represents a fundamental institutional task, to be tackled by every country undergoing postindustrial transformation. The currently observed crisis in the social sphere has its roots not only in the Soviet system's general crisis. Its nature reflects *the crisis of the industrial system.* The present welfare state model (the human potential model development) arose in a fundamentally different demographic and social situation, characterized by growing population, prevalence of younger age groups, and prevalence of rural population excluded from a social support system. Nowadays, when the process of population's ageing has acquired a stable rate, and the demand for social services is permanently on rise, it is necessary to create a fundamentally new welfare state model<sup>8</sup>.

Thus, in a search for an adequate model for human capital development, the international experience accumulated so far can be made use of only to a very limited extent, there currently being no effective systems capable of adequately responding to modern challenges. Moreover, *the country that will manage to create an efficient modern model for developing human capital will thus gain tremendous advantages in the postindustrial world.*

The improvement of economic legislation is another important area for institutional modernization. Much has already been done in this direction in the past ten years. This country is now endowed with a sufficiently well-developed system of economic legislation. Its shortcomings are associated with underdeveloped institutions for political and administrative regulation and weak mechanisms for law enforcement.

At the present moment, the following main directions for further development of economic institutions can be listed as the most important ones:

- *The formation of a competitive environment and overcoming of monopolistic trends in the national economy.* In this connection, the most important goal is to ensure efficient and transparent state regulation, to formulate clear criteria and transparency of decision-making in respect of state participation (and state support) in some specific areas of economic and social life, as well as to prevent a conflict of interests between government officials in regulatory decision-making, and to further improve the mechanisms for government procurements.
- *The promotion of new companies' entry into the market, and the removal of existing barriers in their way.* This is the most important precondition for the intensification of the innovation process, since it is the new enterprises, being prepared to take risks, that achieve, as a rule, a higher productivity level. It would be feasible to create a special infrastructure designed to

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<sup>8</sup> For more details, see *Gaidar Ye. T. Dolgoe vremia.* [A long time]. Moscow, Delo Publishers, 2005. Chapters 12 and 13.

support new small and medium-sized companies, to simplify the access of minor businesses to the leasing of premises, to establish techno parks and business incubators, to promote export of raw materials (including by small and medium-sized companies), etc.

- *The development of the land and real estate market*, because these types of property provide the foundation for property relations and serve as an important source of economic guarantees of property rights. This is especially important for new innovative companies, as a basis for their access to credit resources.
- *The development of financial markets* as sources of capital for economic growth. This will require a higher reliability of financial institutions, the creation and constant upgrading of new financial instruments providing types of savings alternative to the already existing ones, and a more reliable protection of the rights of participants in financial markets.

When forming a system of economic institutions, it is feasible to be oriented to the ways in which EU legislation is being adapted<sup>9</sup>, which is a sufficiently successful example of modern market legislation and of particular importance for this country, since Europe accounts for more than 50% of Russian trade turnover. It is quite natural that not all the sections of European legislation are feasible in terms of growth promotion, but its main sections addressing economic freedoms, antimonopoly regulation, etc. are applicable to modern Russia<sup>10</sup>.

However, when moving in this direction, one important circumstance should by no means be overlooked. European economic institutions require that law enforcement should be effectuated by similarly European-type institutions including, first of all, the judicial system. The one cannot work efficiently enough without the other. But while the laws regulating the economy can be rather easily reproduced in the domestic law and practice, the judicial system cannot be replicated with the same ease – considerable time will be required for ensuring the necessary level of its efficiency. And this is what constitutes one of the fundamental problems faced by modern Russia.

And finally, special place belongs to *development institutions*, which in the past two years have become a very important component of economic and political discourse. There is as yet no clear understanding as to what exactly can be placed within this institutional category: one of the approaches visualizes them as an organizational form for public-private partnerships, another – the forms for direct financing by the State of projects designed to speed up economic growth. It seems that the most precise way would be to define them as discretionary rules of game, that is, government decision-making in the economic sphere that applies not to economic space as a whole but to some specific subjects of economic life.

Development institutions can be both financial (e.g., investment funds) and administrative (e.g., special economic zones). The latter distinction is, however, rather arbitrary. Non-financial institutions are also associated with budget expenditures.

Among *financial development institutions*, there are the RF Investment Fund (hereinafter – Investfond), Vneshekonombank, the Russian Venture Company (hereinafter – RVC), the Agency for Housing Mortgage Crediting (hereinafter – AHMC), Rosselkhozbank, Rosagrolizing, the Russian Nanotechnologies Corporation (hereinafter – Rosnanotekh), the Russian Investment Fund for Information and Communications Technologies, and the Fund for Promoting Reform in the Housing and Utilities Sector.

Among *non-financial institutions*, one can point to special economic zones (industrial production zones, technologies implementation zones, tourism and recreation zones, port zones), technoparks, industrial parks, business incubators, technologies transfer centers, and others.

The most important among development institutions so far have been the following ones:

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<sup>9</sup> For more details, see *Obshchee ekonomicheskoe prostranstvo: Perspektivy vzaimootnoshenii Rossii i ES*. [Single economic space: the prospects of relations between Russian and the EU]. M.: Delo, 2004.

<sup>10</sup> For more details, see *Mau V., Novikov V. Otnoshenie Rossii i ES: prostranstvo vybora ili vybor prostranstva?* [The relations between Russia and the EU: a space of choice or a choice of space?] // *Voprosy ekonomiki* [Issues of Economics]. 2002. No. 6.

- Vneshekonombank, designed to ensure diversification and higher competitive capacities of the national economy, develop infrastructure, promote innovations, and support small and medium-sized companies as well as exports;
- Investfund, for creating national infrastructures designed to ensure regional development and promote the implementation of large-scale private investment projects;
- RVC, which should serve as a base for creating Russia's own venture investment system and selecting the best venture companies through organizing tenders, and to purchase stakes in the venture funds established by these companies;
- special economic zones, in particular the OJSC "OEZ", whose purpose is to create the engineering, transport, innovations and social infrastructures for special economic zones;
- AHMC, for developing housing mortgage crediting in this country by means of refinancing mortgage credits;
- Rosnanotekh, whose goal is to develop innovational infrastructures in the sphere of nanotechnologies and to promote the implementation of related prospective projects by providing their organizational and financial support.

The most important function of development institutions will be to create appropriate conditions for the implementation of long-term investment projects. As a matter of fact, the share of credits granted by Russian banks for a period longer than 3 years presently constitutes no more than 15% of the total volume of crediting. For a number of reasons, and primarily the lack of credit history displayed by nearly all the participants in economic life, private investors do not dare to take upon themselves long-term credit risks. However, if one has in mind the use of development institutions, one must also be aware of the existence of some serious risks: on the one hand, their substitution for private businesses (and private risks) during the implementation of commercially attractive projects, on the other – subsidizing of loss-making enterprises or branches for political reasons (or by way of corruption).

Time will show just how efficient these institutions are going to be. In principle, the reasons for their creation are rather understandable. There exists a politically motivated desire to speed up economic growth and the diversification of the economy and exports, as well as to compensate for the absence of credit histories. No less important is the very fact of availability of enormous financial resources, inevitably serving as the object of political struggle.

However, the most fundamental problem faced by development institutions is that nearly all of them have their roots in the industrial era, when the State was capable of centrally determining the priorities of long-term development and concentrating resources in these areas. But it becomes increasingly difficult to set priorities in this manner in a situation of the highly dynamic demand and technologies typical of the postindustrial era, when the price of an error is too costly.

There is also yet another open question as to whether it would be possible to prevent development institutions from becoming a factor of macroeconomic destabilization. So far they have been attracting strong inflow of budget funding. Only in November of last year, 300 billion rubles from the Stabilization Fund were directed to refinancing Vneshekonombank, Investfond and Rosnanotekh.

The most important area of institutional reform is the implementation of *priority national projects*. The general idea itself, as well as the principle for their selection, is indisputable since it has to do with the development of human capital, which is a very real priority in conditions of postindustrial transformation. From the very start, two fundamental directions for their implementation have become obvious: the strengthening of budget financing of the related sectors, and institutional reform. It would be both politically dangerous and economically unfeasible to try to solve one of the problems while ignoring the other. However, the risk of such a course of events is very real<sup>11</sup>.

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<sup>11</sup> See Rossiiskaia ekonomika v 2005 godu: tendentsii i perspektivy. [The Russian economy in 2005: trends and prospects]. M: IET, 2006.

At the first stage, the budget aspect was clearly dominating over the institutional one, and this caused serious concerns, since financing without institutional reform could even produce a negative outcome. Higher salaries result in personnel conservation instead of personnel upgrading, when government-paid physicians and teachers, who have long ago lost their former level of qualification and are not going to treat their patients or teach their students any better even if their salary level is raised hundred-fold, hold on to their posts. Higher expenditures on equipment may result in its overpricing and in selecting items that are not really needed by public hospitals and laboratories. And increased funding of public housing construction in face of a monopolized construction services market can produce only skyrocketing prices and enrichment of local monopolists.

The year 2007 saw certain important shifts in the implementation of national projects.

Firstly, their long-term character received an official recognition. Initially, in September 2005, the projects were declared for a period of 2 years, which made them seem to be part of the election campaign and was evidently not compatible with the scope of the country's goals. Now it has been officially recognized that human potential development represents a strategic goal, to be achieved in a foreseeable future.

Secondly, the focus on institutional reforms has evidently become more pronounced. This can be felt in different ways within each category of priority national projects. Most consistently the institutional aspect is visualized in public education, where reformers have achieved a consensus in respect of the main directions of its modernization. Last year, a package of laws was adopted, which determined the most important area of public education development in the medium term. In other sectors, discussions are still going on as to which institutional decisions are the most urgent ones. This is not surprising, since the elaboration of efficient decisions in sectors belonging to the social sphere represents an enormous intellectual task, while international experience can be borrowed from only to a very limited degree.

Thirdly, some success has been achieved in dealing with the specific tasks of improving these sectors' functioning. Schools are being equipped with computers, the equipment of hospitals is being upgraded, and other practical problems are also being solved.

Fourthly, the implementation of national projects is increasingly based on tenders among the draft projects submitted by individual institutions and regions. The lack of ready-made and obvious solutions to the problems faced by human capital has resulted in a decision (quite reasonably arrived at) to create incentives for the social policy subjects to elaborate their own proposals and to submit the resulting versions of decision-making to the federal government.

#### 1.2.4. Trends and Risks

For 8 years already, the Russian economy has been developing at a persistently high rate. This is an undisputable source of economic well-being and political stability. However, this favorable situation has also its reverse side. A new generation of Russian politicians is emerging, who are becoming used to "welfare growth management"<sup>12</sup> and are increasingly oblivious of the crisis management skills. The same habits are becoming increasingly common among the population at large. However, the Russian political system's stability – just as, in a certain sense, the legitimization of the existing political regime – depends on its ability to truly ensure this high rate of economic growth and public welfare.

Meanwhile it should be remembered that an economic boom may last for a long but by no means indefinite period, especially given the fact that Russia's success builds upon such unstable factors as high prices of energy carriers and the availability of cheap money on international financial markets. As for the institutional environment, which alone can be a reliable guarantee of stable economic growth, it is regrettably underdeveloped. Russian institutions (economic as

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<sup>12</sup> This expression was used by X. L. Portillo (Mexico's President in 1976–1982), when on the peak of the oil boom he believed that now his country would be moving from one success to another. In a few years, this ended in a collapse.

well as political) are still hardly capable of softening and adjusting the consequences of both a worsening economic situation and a potential economic crisis.

A slowdown in economic growth, or, more dangerously, a slump, in our situation can be fraught not only with economic problems but also with political crises. A threat of a dramatic fall in the growth rate may produce an inadequate response on the part of the authorities, which would only exacerbate the economic problems. Our further development, in many of its aspects, is very dependent on the authorities' ability to adequately and calmly deal with a crisis. Therefore, *another most important problem faced by Russia's currently existing political and economic system is the necessity to adequately respond to possible shocks*. This will be the main test for the maturity of the Russian political and economic elite.

*The causes and sources of a possible crisis* cannot be forecasted with certainty. On the basis of the contemporary realities and trends one can single out several sources of potential problems influencing economic growth and conducive to political and financial destabilization. These, however, are very closely interconnected.

*Firstly*, it is the onset of a global recession, which has been in the air for some time already. This will mean transition to another phase of the business cycle, which for Russia may become especially painful by contrast with its currently high rate of development. Throughout the greater part of the 20<sup>th</sup> century this country was safeguarded from the cyclic fluctuations characteristic of a market economy. However, there are no grounds for believing that we are going to be similarly impervious to such influences in the future. Moreover, the lack of any experience in applying a cyclical adjustment policy, well-known to the market economies of the past century, makes Russia especially vulnerable to the threat of cyclic fluctuations. And since the Russian economy has not yet been integrated into the global economy to such an extent as to participate in the cyclic adjustment regulation adopted by developed countries, one may expect, sooner or later, that one more classical economic crisis will unfold here.

*Secondly*, a drop in oil prices. Nowadays hardly anybody regards this as a serious option, but it cannot be entirely ruled out. One has only to recall the 1970s, when everybody was sure that the prices of fuel and energy resources had reached a new plateau. Besides, a crisis must not necessarily be provoked only by a fall in prices below 10 USD per barrel. In recent years, Russia has already gone a long way toward increasing its budget expenditure and the domestic situation's dependency on the fluctuations of the global economic situation. Any relatively significant drop in oil prices will have a painful impact on budget liabilities, which can hardly be successfully compensated for by the Stabilization Fund's resources. Moreover, the exacerbation of Russia's economic troubles will occur in face of a worsening situation in the majority of the world's leading economies, while Russia's competitors in business will have additional stimuli for growth due to declining oil prices.

*Thirdly*, there is a possibility of a deficit in the balance of payments, and the ensuing dependence of this country's domestic status on the inflow of foreign investments. In this situation, foreign investments can become a crucial growth factor, at the same time being critically dependent on the state of Russia's political, legal and economic institutions. It is these institutions that are capable of either making a country attractive for foreign capital, or of becoming a major obstacle in its way.

*Fourthly*, destabilization may also be associated with the onset of an energy crisis. The rapidly developing Russian economy requires and will continue to require an increasing amount of energy resources. At the same time, the activity of energy producers (mainly oil and gas companies) in surveying and developing new deposits is very low. We are still regarding this country as a big energy producer (lately, a new term has appeared – “energy superpower”), considering it as one of the foundations of “sovereign democracy”. However, the real course of events may very soon give rise to disillusionment. An energy crisis is in no way conducive to political stability or further consistent economic growth – it can by itself serve as a powerful factor of recession.

And fifthly and finally, serious problems can arise in the future as a result of the rapidly increasing external debt. There are two reasons why such a situation can be very dangerous.

On the one hand, there is a growing dependence of the national economy on the situation on the international financial markets. Today, when the price of borrowings is low, economic growth in Russia is sustained by a substantial inflow of external credits. The availability of cheap credits is no less important for growth than high prices of oil and gas. However, a changed situation on the debt market may give rise to serious economic problems. Increasing costs of credit resources will then become a very important restricting factor in the way of economic development.

On the other, more expensive borrowings may create grave problems for the state budget. Many borrowing companies are closely connected to the State and operate on the principle of “privatization of profits and nationalization of losses”. This is also the way they are perceived by financial markets, where it is well understood that, in the event of a crisis, Russia’s biggest private borrowers will be able to rely on the support from the federal budget. Thus there emerges a situation known since the 1997 Asian crisis as *moral hazard*, when some may irresponsibly borrow money, while others may grant this money without giving the matter any serious consideration.

Another problem worth discussing in the medium- and long-term perspective is the continuing social and regional differentiation. These processes, quite explicable in the initial phases of economic growth and the economy’s structural adaptation to new challenges, are fraught with serious threats for future stability.

Rising inflation represents a grave problem, as well. The growth of inflation in 2007 was in part the result of the pre-election policy of whipping up economic growth, and reflected the desire of the ruling party (in the broad sense of the term) to enter the parliamentary and presidential elections on the crest of this wave. Moreover, the upward trend of prices is already guaranteed to continue in 2008, since the bulk of budget allocations of last year was spent in November and December. And this circumstance, as shown earlier, will have a suppressing effect on domestic production (through increasing interest rates).

Any responsible government will have to curb this trend. As early as mid-2008, there will emerge a need for a switchover to another policy, aimed at preventing the economy’s overheating through improving the structure of economic growth. But there also arises another key question, of a purely political nature: will the new President and the new Chairman of the Government agree to it? If the answer is yes, this will mean their taking full responsibility, which is fraught with the risk of losing popularity. They will then be responsible for slower growth and the hardships associated with structural reforms. However, this choice will be inevitable, and no later than 2008.

Serious risks are also inherent in the investment projects being implemented in the sphere of public-private partnerships (PPP). This currently fashionable model implies the pooling of government and private resources in order to provide solutions to major problems faced by the national economy. It is assumed that private businesses invest in construction of enterprises, while the State invests in related infrastructure. All the experience of the State’s participation in business has demonstrated the low efficiency of such participation and the need for much higher expenditures in terms of time and money than those initially planned. As a result, one cannot entirely rule out a situation when private businesses persist in realizing their part of a project, while the State (quite significantly) falls behind the approved schedule. Thus, the effect of such projects will be markedly diminished.

This is also fraught with the additional risks resulting from global recession. The investment strategy currently adopted by the State and related big businesses, in fact, builds upon the hypothesis of long-term constant growth. Substantial resources are being invested in the development of new export-oriented production, primarily of non-ferrous metals, which constitute an important component of Russia’s non-energy exports. However, the demand for such products is very sensitive to the fluctuations of the international market. When there is a

boom, both demand and prices grow rapidly, while during recession the trend is exactly reverse. But the output of the newly created businesses is oriented to the contemporary level of demand, which can be fraught with severe financial losses – first of all, for the state budget. The State is a big investing partner in the corresponding projects (mainly in providing appropriate infrastructure), being so closely associated with private businesses that it will be obliged, most probably, to take it upon itself to compensate for their losses in the event of a recession. But this can also lead to a serious macroeconomic crisis.

An important trend in this country's long-term development will also be the existence of a stable one-and-a-half-party democracy. This type of regime, typical of Mexico throughout the greater part of the 20<sup>th</sup> century, is now emerging in contemporary Russia. This is quite natural for a country with a medium level of development and the availability of a powerful source of "cheap money". The one-and-a-half-party democracy can ensure long-term political stability, while at the same time creating additional risks inherent in large-scale corruption and a relatively low efficiency of the basic political and legal institutions. Only the actual course of events will show just how stable the emerging system of power is going to be, and whether it will possess intrinsic mechanisms of modernization.

And the last but not the least key problem of Russia's socio-economic development will remain its readiness and ability to ensure macroeconomic stability. Despite the impressive size of the Stabilization Fund and the unprecedented foreign currency reserves of the Russian Federation, its long-term stability is in no way guaranteed. Just a few errors in macroeconomic policy will be enough for stability to quickly disappear. Moreover, crisis is virtually inevitable, as is taught by the logic of post-revolution development, when periods of stability periodically give way to political explosions, as well as by the logic of economic cycles characteristic of market economies. Thus, our task for the future is to adapt our policy to the functioning under the conditions of the global market.